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E.O. 12958: N/A
TAGS: ECON EFIN ELAB PGOV IT KPRP
SUBJECT: ITALY: COMPETITIVENESS AND GROWTH PROGRAM, PART I

Ref: A) Rome 1900, B) Rome 1588

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¶1. (SBU) Summary and Introduction: The Senate gave final approval May 12 for the first part of the 2005-2008 four billion euro plan to improve Italian competitiveness and implement EU Lisbon agenda reforms. The package will likely be the government's most significant piece of economic legislation between now and the next national elections. The second part of the package is still under debate in the Chamber of Deputies (septel). The recently passed law attempts to streamline bureaucratic procedures, support businesses, invest in infrastructure, combat counterfeit goods, improve unemployment benefits in some sectors and geographic regions, and reorganize government tourism promotion. On the revenue side, the decree increases liquor taxes, fines for buying knock-off goods, and penalties for hiring under the table. Unions doubt the law will spur competitiveness, while the business association Confindustria approves, but calls for additional measures. The opposition sees the decree law as an electoral gambit, void of any real structural adjustment measures. This message evaluates key measures in the new law. End Summary and Introduction.

Customs Upgrades; IPR Enforcement; "De-Outsourcing"
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¶2. (SBU) The new law seeks to bolster domestic jobs, protect Italian brands, and modernize borders systems handling goods and people. Customs/Immigration computer systems will be upgraded further to the Member State requirements under the EU Visa Information System (VIS) II, due to begin operation in 2007. On IPR, the law imposes administrative fines of up to euro 10,000 for knowingly purchasing counterfeit goods. Comment: Embassy experience with other IPR protection measures indicates that Italian law enforcement authorities are loath to enforce anti-piracy laws at the retail level. With this in mind, the new provision may have little impact on piracy violations (see Ref. A). End Comment.

¶3. (U) The law also provides tax incentives for companies that have outsourced activities and now return these activities to Italy. It withdraws benefits and tax incentives for companies moving R&D, front-office activities and a significant part of production offshore.

But No Bankruptcy Reform or Deregulating High-End Services
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¶4. (SBU) Italy is renowned for the relatively large size of its small-enterprise sector. Unfortunately, these businesses are concentrated in declining industries; their owners are generally risk-averse; and they invest modestly in new technologies and innovations. Thus, Italy needs comprehensive bankruptcy reform to help build a culture of entrepreneurial risk-taking and create jobs in high-growth industries. As a first step towards more comprehensive reform of the bankruptcy code, the draft decree attempted to lower the maximum sentence for bankruptcy fraud from ten to six years. This provision raised widespread protest, was seen as inconsistent with efforts to strengthen corporate responsibility, and ultimately was dropped from the law. Separately, lack of open access to enter many professions and protection from foreign competitors cause distortions in the Italian labor market. Unfortunately, however, professional bodies killed a provision that would have promoted a limited liberalization of professional services, strengthened competition among service providers, and allowed professionals to become shareholders of their own companies.

Administrative Simplification or Abdication?

--5 . (SBU) One measure meant to break administrative bottlenecks in initiating new business activities, provides for "silent consent" if the responsible public authority does not act on administrative requests within 30 days. Critics worry that rather than improving administration of business licensing requests, "silent consent" could increase political influence over administrative decisions affecting business. It is not difficult to envision a scenario in which insiders could receive "silent consent," while other businesses receive endless requests to provide additional information, obtain additional authorizations, and the like.

Infrastructure: Tossing a Bone to the South

¶6. (SBU) The government will reallocate euro 750 million from a fund for industrial development to nudge forward fourteen major infrastructure works in the underdeveloped south of Italy, an area crucial for Berlusconi's hopes in 2006 national elections. The full cost of these fourteen projects is euro 43 billion; the euro 750 million allocated may provide the pre-electoral appearance of progress but is unlikely to make much of a dent in these projects. No provision is made in this package for additional, subsequent funding, although additional funds could in theory be included in the next budget bill.

Incentives to Merge, but Also Dinosaur Crutches

¶7. (SBU) Manufacturing still represents about one quarter of the economy in Italy, higher than in other G7 countries. This manufacturing is concentrated in areas (textiles, furniture, appliances, etc.) in which Italy has been loosing its competitive edge. The new law provides a thirty-percent tax credit for small-and medium-sized enterprises (SMEs) to encourage mergers of Italy's many small companies in sectors that have lost their competitive position on the world market. The law also earmarks another euro 310 million to help small clothing manufacturers, as well as all the suppliers and sub-suppliers of the Fiat Group. The law adds the home appliance sector to the group of companies that can draw from the fund for restructuring distressed companies. This measure is targeted at Whirlpool and De Longhi, both of which are considering lay-offs at northern Italian manufacturing facilities.

Stretching the Safety Net

¶8. (SBU) The new law seeks to extend the social safety net to employees of smaller companies and the longer-term unemployed, increase labor mobility, and decrease reliance on the government pension system. The measure gives private-sector employees the option of investing the seven percent of their salary currently held by their employer for a lump-sum severance/retirement payout into a self-directed supplemental pension fund. The law also earmarks funds to reimburse companies for diminished cash flow resulting from employees moving these funds from company control to pension plan managers. In addition, the law modestly extends the duration of unemployment benefits, but calculates the payout on a lower percentage of the beneficiary's final salary. A wage guarantee fund (euro 460 million) is established for SMEs. The law establishes bonuses for new employees taking jobs more than 100 km from their residence.

Reshuffling Tourism Promotion

¶9. (U) The law identifies cultural tourism as a priority and authorizes Italian tourism information desks in six countries. The law establishes a cabinet-level committee to set national tourism priorities and sets up a 20 million euro fund for promoting tourism in Southern Italy.

Comment

¶10. (SBU) The changes in the new competitiveness package are, on balance, positive, but insufficient. Given the extent of the economic challenges confronting Italy, it would be unreasonable to expect any competitiveness law to be a panacea. That said, this legislative effort only nibbles at the edges of Italy's structural problems and is not expected to have a noteworthy impact on the economy over the next year. The second part of the package (to be reported septel) is also expected to include provisions to improve Italy's competitiveness, but may be shaped even more by political parties' jostling in the run up to 2006 national election. End Comment.

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